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CONFIRMED AND UNCONFIRMED LETTERS OF CREDIT  
IN CZECHOSLOVAK FOREIGN TRADE

[Comment: This report summarizes an article by A. Hrdina, in *Zahranicni Obchod* (Foreign Trade), No 9, September 1954, published by the Czechoslovak Ministry of Foreign Trade in Prague.]

Since World War II, letters of credit have become the most commonly used method of payment for goods in international trade with capitalist nations. This method of payment was put into practice because letters of credit permit the seller to receive payments for goods immediately after shipment. The buyer receives assurance that the payment will be made only if the seller promptly and properly fulfills the conditions of the letter of credit which were established by the buyer in advance. In the use of letters of credit, however, one important problem arises; that is, the problem of confirmation of the letters of credit. Czechoslovakia has not yet devoted adequate attention to this problem.

Many workers in foreign trade and in the international payments system clearly understand the difference between, and the importance of, confirmed and unconfirmed letters of credit. However, there are also those who view letters of credit in international trade as a guarantee to the seller that if he properly and promptly satisfies the conditions of the letters of credit, he will be compensated in the amount specified in the document, and that the question of confirmation of the letters of credit is a matter to be dealt with by the banks.

The 13th Congress of the International Chamber of Commerce, held in Lisbon in 1951, accepted a set of resolutions dealing with letters of credit. [Article quotes from Paragraph 5 of these resolutions which defines the responsibilities of the bank to the beneficiary of the letter of credit it has issued.

First, let us study the significance of confirmed letters of credit for Czechoslovakia's export trade. An irrevocable letter of credit issued by a foreign bank is always confirmed by that bank. This means that the bank will pay to the Czechoslovak beneficiary the amount specified in the letter of credit when the conditions of that document have been satisfied. This applies in the cases of most types of "Commercial Letters of Credit" issued by banks in Britain, the North American countries, and in the Middle and Far East. The letter of credit is sent to the beneficiary in its original form through the medium of the State Bank or sometimes directly, and the bank is authorized, like any "bona fide holder" of the instrument, to purchase the letter of credit, and then claim the amount it paid to the exporter from the foreign bank which issued the letter of credit. This applies even if the "bona fide holder" of the instrument is a bank in a third nation, one other than the exporting and importing nation.

The same applies to letters of credit of the "European" (continental) type by which a foreign bank notifies the State Bank that it has issued an irrevocable letter of credit in favor of a Czechoslovak seller and requests the State Bank to notify the beneficiary of the letter of credit, without authorizing the State Bank to attach its confirmation.

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In neither case, therefore, is the State Bank under obligation to the Czechoslovak exporting Foreign Trade Enterprise (PZO). The State Bank merely occupies the position of an intermediary who relays or interprets the message it has received. Only upon the negotiation, that is, the purchase of the instrument, does the State Bank assume any legal relationship to the foreign bank and to the local foreign trade enterprise. From the practical standpoint, this means that the State Bank purchases the instrument with the reservation that it alone shall receive payment for the instrument which it has negotiated. The appropriate equivalent of the foreign bill of exchange is turned over to the Czechoslovak foreign bill of exchange management only after the instrument has arrived in the foreign country. At least enough time must be allowed for the instrument to be forwarded by mail to the foreign bank and for the credit balance or notification of payment to be returned to the State Bank.

In cases of letters of credit confirmed by the State Bank, the State Bank itself assumes a legal relationship to the beneficiary. It pledges, on the basis of a pledge by the foreign bank, to pay to the local foreign trade enterprise the amount specified in the instrument when the conditions of the letter of credit have been satisfied. The fact that the State Bank itself incurs an obligation through the letter of credit not only leads to determine the foreign bank's ability to pay, just as it does in the case of all letters of credit issued by foreign banks, but also gives the State Bank the power to ascertain directly the financial coverage of the letter of credit. This is ensured by the fact that the coverage for the letter of credit is confirmed by some first-class foreign bank. If the letter of credit was issued on the basis of Czechoslovak crowns, the State Bank may demand payment in advance. Advanced coverage for letters of credit given to the State Bank by a bank in a foreign country cannot be used by the State Bank until it has made payment. It is evident that the negotiability of foreign bills of trade is more convenient for the entire foreign trade economy than the use of unconfirmed letters of credit.

We know from experience that British and North American banks are not willing to permit their "Commercial Letters of Credit" to be confirmed by other banks, even though in reality this has occurred. This is a remnant from the days when only one world market existed, and when British and North American banks stood out as world banks controlling international payments. Confirmation of letters of credit issued by these banks indicated a lack of confidence in the bank's financial position.

It is necessary to understand that in the confirmation of letters of credit, the banks charge fees according to an established system of rates, and that in the case of Czechoslovak exports, these charges must be borne by the foreign buyer. Bank charges for confirmation of letters of credit are normally double those charged for issuance of the letter of credit. Therefore, it is not always easy to persuade the foreign buyer to allow the State Bank to confirm letters of credit to the local foreign trade enterprise, which is handling the export order.

In the cases of Czechoslovak imports, the foreign seller desires that the Czechoslovak Foreign Trade Enterprise as the buyer, issue an irrevocable letter of credit confirmed by the seller's bank. The extent of the seller's interest in making the sale and the nature of the goods determine whether he will possibly accept an irrevocable letter of credit issued by the State Bank, and allow his bank merely to deliver the letter of credit to him, or perhaps permit the State Bank to send the letter of credit directly to him. This can be done only in cases of letters of credit issued by the State Bank.

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This then would be a type of Czechoslovak "Commercial Letter of Credit." This method could be applied to letters of credit issued in Czechoslovak crowns. Probably it could be applied in cases of letters of credit issued on the basis of currency of a third nation. Certainly, however, in many cases the foreign seller would be satisfied with a letter of credit merely transmitted to him by his bank, without regard for the currency basis on which the letter of credit was issued. In all these cases this would mean that the settlement of foreign bills of trade would occur only after presentation of the required documents in the foreign nation and after the State Bank had been notified that the documents had been presented, or even after the State Bank had received the documents. If the foreign seller insists on a letter of credit confirmed by his bank, this can be accomplished by his paying the confirmation charges.

Proper demands in Czechoslovak export for the use of letters of credit confirmed by the State Bank and the proper use in Czechoslovak import of letters of credit not confirmed by foreign banks, would provide advantages in the management of foreign bills of trade, would permit savings on charges required by foreign banks, and would increase the income from payment exacted from foreign banks. In addition, such conduct of business would also fulfill Czechoslovakia's plan of foreign trade activity as outlined by Comrade Novotny at the Tenth Congress of the Communist Party of Czechoslovakia; that is, to contribute to the brisk development of commercial relations with all nations according to the principles of equality, and on the basis of providing mutual benefits.

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